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The comparative advantages of single and multi-stakeholder co-operatives

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T5: Co-operative Governance and Organisational Design
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Abstract

When co-operatives were first invented, it was assumed their membership would be limited to one type of user. The Rochdale Pioneers favoured consumers, and employee representation was deliberately limited to a set percentage of board members. Similarly, Schulze Delitsch and Raiffeisen privileged farmers, Buchez workers, insurance mutuals those who are insured, and so on. Recently, Italian social co-operatives have developed a different model in which all the relevant stakeholders become members: those who are cared for, the carers, the workers, and volunteers. Also, occasionally dual stakeholder co-operatives have been designed. Eroski, the big retailer located in the Iberian peninsula, has both consumers and workers in membership, and iCoop in Korea has both consumers and farmers. This paper has two aims, to set out some of the theoretical arguments for and against multi-stakeholder governance, to look at examples of multi-stakeholder models in practice, and to generate from this a set of research questions.

Introduction

When co-operatives were first invented, it was assumed their membership would be limited to one type of user. The Rochdale Pioneers favoured consumers, and employee representation was deliberately limited to a set percentage of board members. Similarly, Schulze Delitsch and Raiffeisen privileged farmers, Buchez workers, and so on. It is true that before these familiar types of co-operation crystallised there was a period of idealism, when utopian socialists such as Robert Owen and Charles Fourier were advocating a co-operative community in which membership would be much more holistic. Their vision did not survive much contact with reality, whereas co-operative stores for consumers prospered. There was also sometimes a period of confusion, when promoters were unsure about which stakeholder to put at the centre of the co-operative. William King set up co-operative stores that were both consumer and producer owned (with artisans bringing goods to sell through them), until it was realised that their interests could clash (Birchall, 1994). Raiffeisen set up rural banks in which investors had control, until he realised that they had to be owned by the farmers (Birchall, 2013). The emergence of single stakeholder co-operatives could be seen as a process of organisational evolution; every other type failed to survive and reproduce itself over time.

The assumption that co-operatives should give membership to a single-stakeholder continues in the rules that they develop to prevent multi-stakeholding emerging. For instance, quite soon in their evolution, consumer co-operatives began to limit the number of employees who could be elected to a board. Furthermore, membership was seen as being for consumers, and employee board members had to see themselves primarily as representing consumers. Another example is insurance mutuals that, though they began to appoint experts to their boards, established a tradition that a majority of board members should represent policy-holders (Birchall, 2011, Ch.1). Housing co-operatives have also developed rules that ensure a majority of residents on their boards. Some farmer co-operatives have recently appointed one or two experts to their boards, but others are resisting the idea (Birchall, 2014).

Why, then, should we want to discuss the idea of multi-stakeholder ownership and governance of co-operatives? It is because practices are changing.

Occasionally dual stakeholder co-operatives have been designed. The Spanish health co-operative Espriu has both doctors and patients on some of its boards, Eroski, the big Spanish retailer, has both consumers and workers in membership, and iCoop in Korea has both consumers and farmers. Recently, Italian social co-operatives have developed a governance model in which membership is open to more than one of the relevant stakeholders. Practice varies, but membership is open to some combination of workers, volunteers, other non-profit organisations and service users. The social co-operative sector is growing and being copied elsewhere. However, it operates typically in social care services where non-profits have traditionally provided services under contract to local authorities, and so it may or may not have more general applicability.

This paper has three aims: to set out some of the theoretical arguments for and against multi-stakeholder governance, to describe some examples of multi-stakeholder models in practice, and to generate from this a set of research questions.

Economic theory and the assumption of single-stakeholder ownership

Mainstream economic theory lends weight to the argument that multi-stakeholder ownership will not work. In a small business where the owners carry out the tasks of management and oversight themselves, there is no need for a separate governance function. As soon as they appoint a separate group of managers to run the business, the problem emerges of how the principals (the owners) can control the agents (the managers) so that their interests are aligned and managers do not engage in 'rent-seeking' behaviour. Governance is seen as a cost to the business rather than an activity that adds value. Transaction cost economics adds to this analysis with two propositions. First, if giving ownership rights to a particular stakeholder group leads to high cost of governance compared with those of their competitors, the business will suffer. If a change of ownership type reduces such costs, then eventually (other things being equal) it will be chosen. Conversions - such as from consumer to investor ownership, or from investor-ownership to employee ownership - can be explained in this way.

Second, there are also costs from *not* bringing a particular stakeholder group into ownership. If their co-operation is needed by the business it is secured through contracts the cost of which is determined through the market. For instance, the conventional capitalist solution is to have investor-owners and to contract with employees through paying them wages. However, there are circumstances where other type of ownership will be promoted. For instance, if an industry is prone to monopoly over crucial parts of the value chain, producer-ownership will prove more attractive than investor-ownership. This explains the popularity of farmer co-operatives (Hansmann, 1996).

What economic theory does not predict – in fact, does not even consider – is the possibility that more than one stakeholder group could take ownership (Borzaga and Sacchetti, 2015). It is assumed that stakeholder groups have essentially different interests that can only be brought into alignment through market contracting. If they are brought into ownership, then their interests have to be aligned through the system of governance. Since the costs of such governance will be too high (relative to competitors who do not need to incur such costs), the business will suffer.

A strong argument for multi-stakeholder co-operatives

Shann Turnbull has developed a strong argument for joint ownership by employees, consumers and suppliers. Such a co-operative would have three separate boards to represent these interest groups, and they would together make up a compound board. He calls this ‘distributed control’.

His argument against single-stakeholder ownership has three parts. First, centralised control is corrupting. Directors have too much power to maintain their positions while obtaining private benefits for themselves. Second, there is a lack of information by which board members can challenge the status quo. There is a lack of independent feedback information on performance. Directors become ‘largely captive to the information provided by management’ (Turnbull, 2001 p178). Third, there is information overload, which means that directors cannot effectively process the information they need.

All these criticisms of unitary boards are familiar and we do not need much convincing of their merit. However, the mainstream literature on governance also sets out to tackle these problems, seeing them not as inherent to unitary governance but as faults that can be rectified. What Turnbull advocates is a complete redesign of businesses and we need to be convinced that his solution does not just produce another set of problems. At the heart of his solution is the introduction of greater complexity into the governance system, with boards being accountable to a higher authority that contains all the stakeholder interests. This is variously known as a supervisory board, stakeholder council, or watchdog board. Of course, this kind of design is also common in single stakeholder co-operatives. Multi-stakeholding adds the challenge of reconciling diverse interests before they reach the main board as well as enabling them to come together again at a higher level to supervise the board.

There remains the question of how the interests of such a diverse group of owners can be reconciled. Much of the time they will have a common interest in the effective running of the business, but there must be moments when they have to decide who gets what from the value added. They cannot all benefit equally or all the time, nor can they always be expected to agree on what is fair. Another issue concerns the examples that are given of distributed ownership in practice. Turnbull lists the Japanese Keiretsu, employee-owned firms and the Mondragon co-operatives. The Keiretsu are a good example; here the firm distributes shares to employees and suppliers in order to bind them into the business. It could be described as 'distributive capitalism' in that it widens the ownership of firms. Also, because firms invest in each other, it creates an informal business network. What is unclear is whether employees benefit from increased authority in the governance structure; this would depend on the extent of their shareholding in any one firm and on whether they are incentivised to make the most of this.

Employee-owned firms are not a good example of multi-stakeholding as they are either single-stakeholder co-operatives (if 100% owned by employees) or hybrids (if majority owned by employees along with other investors). A firm that is owned by a combination of workers and investors is a kind of multi-

stakeholding or at least 'dual stakeholding', but some commentators see this as an unstable mix that should be encouraged to lead to full employee-ownership (Ellerman, 1990).

There are other examples of producer co-operative hybrids. Some food processing companies are now owned by a mix of farmers and outside investors. Kerry Group is a good example, though the farmer stakeholding has fallen recently to just over 13%. Other food processing companies are majority owned by farmers (Emmi in Switzerland is a good example), but in some cases the farmers have bought back their side of the business because they do not like sharing control with other investors. In Ireland, Lakeland Co-operative and Glanbia Co-operative have succeeded in buying back their dairying business. The only strong argument for a mix of producer and investor ownership is the need for more capital that outside shareholders can provide (Briscoe et al, 2012).

The Mondragon system looks at first sight to be another weak example of multi-stakeholding. At the level of the individual co-operative, most are still conventionally owned either by workers, consumers or farmers. However, at the higher level, of the Corporation, there are elaborate governance mechanisms for ensuring the different types of co-operative are represented. Also at Mondragon there is one genuine worker and consumer owned retailer in the Group, Eroski (the Spanish co-operative retailer, Consum, has a similar ownership structure).

There are a few other interesting examples of multi-stakeholder ownership that might support Turnbull's argument. iCoop is a very successful consumer-farmer owned co-operative federation in Korea which we will examine in more detail below. There are two health co-operative federations that have both producers (medical doctors) and consumers (people insured through health plans) on some of their boards; Unimed in Brazil, and Espriu in Spain (Birchall, 2014 ch.6).

However, in both these cases the producer interest predominates. A cynical view might be that the development of health plans is a way that medical doctors can gain business for themselves, and that having some consumers on the board is a necessary part of their legitimation. In practice, though, there is no reason for such cynicism; the common interest of both producer and consumer in having an effective health care system does seem to hold them together. On the other hand,

the dominance of the medical interest is evidenced by the fact that government legislation has also been necessary to ensure the consumer interest is properly safeguarded in the governance of their health insurance mutuals.

We will now look further at two clear examples of multi-stakeholding - Eroski and iCoop – before examining in some detail the most well known example of the Italian social co-operatives.

The examples of Eroski and iCoop

Eroski is a supermarket chain that began in 1969 in the Basque region, with the merger of 10 consumer co-operatives, but has now spread out into other parts of Spain and France. It is a highly successful business, with 1896 stores (including supermarkets, super stores, cash & carry, opticians, travel agents, perfume stores and sports shops) and an annual turnover of more than €6 billions (Eroski, 2015). It has 33,509 employees and over seven million customer members, and is a member of the Mondragon Corporation.

Eroski's governance system is a hybrid of the Mondragon worker ownership system and of a conventional consumer co-operative; it describes itself as a consumer co-operative in which the workers are owners and the consumers are members. However, in order to become an owner an employee has to invest a significant amount in the co-operative; only 11,858 are 'worker partners' out of a total of 33,509 workers. The 'client partners' are a much higher proportion of the customers, accounting for 76% of sales. The incentives are very different: worker-owners share 40 percent of the profits, while consumer members receive discounts on purchases.

The annual general meeting consists of 250 worker and 250 consumer representatives, who then elect a governing board of six worker and six consumer partners. This governance system is supplemented by worker self-management in the stores and by 21 consumerist committees that provide guidelines for the co-operative. It is interesting that the president of the co-operative has to be a consumer rather than a worker member; anecdotally, the view of commentators who know the business is that the worker interest tends

to dominate. This is only to be expected, since the workers have a much larger stake in the business, both as employees and as shareholders.

iCoop is also a successful retailer, with 180 stores and 17 factories for farm produce. At first sight, it is a similar mix of consumer and producer ownership (the producers being local farmers). Its 2015 annual report says it has 237,000 consumers and 2367 producers in membership. However, it is not a primary but a secondary co-operative; the individual consumers and workers are grouped in 85 consumer and 33 producer co-operatives. It puts the emphasis on the consumption side of the equation, describing itself as a 'consumer co-operative federation' of 'consumer members who practice ethical consumption and production with producers' (iCoop, 2015). It owns a Mutual Aid Society for Enhancing Korean Agriculture that has business with consumers, producers and employees, but this is an insurance mutual so that its customers are all simply insured persons. The farmers are grouped into an association of producer groups.

The problem of how to reach a price for products is therefore solved within the market. The federation supplements this with a member account fund in which consumers make advance payments so that farmers can grow their produce without having to go into debt. It also has a price stabilisation fund that intervenes to smooth out farm prices over the year. The federation enables a genuine solidarity to be expressed between consumers and producers, but it keeps them separate so that their interests do not have to be completely reconciled.

The Italian model of social co-operatives

Organisations that provide social care for vulnerable people have a particular problem. Those who they are caring for include people with learning difficulties, people who are physically or mentally disabled, older people suffering from dementia and so on. They cannot always be relied on to look after their own interests either as purchasers of care or within the governance system of the co-operative. In economic theory, we might say the costs of both contracting and of governance are too high. This problem was analysed by Hansmann (1996), who

recognised a dilemma. On the one hand agency costs would be exceptional if users had to own the firm. On the other hand, there would be a clear disadvantage from being excluded. Hansmann's solution is that the organisation should be constituted as a non-profit in which nobody owns the enterprise and a board of trustees provides its governance. The trustees are trusted to act on behalf of the service users.

A different governance solution is exemplified by the social cooperative model, which has developed in Italy since its inception in 1991 (Law 381/1991). This model was explicitly engineered to be multi-stakeholder. Here the service users have the right to be part of the assembly of members and represented in the governance structure along with all the other main stakeholders: workers, volunteers, carers, other legal entities such as co-operatives and financial members. Multistakeholding requires specific governance solutions and has implications for governance costs (Sacchetti and Tortia, 2014). At the same time, however, it enables the inclusion of a plurality of interests which can lower the costs of coordinating transactions on the market (borne by the internal patrons), but also the external costs associated with the exclusion of stakeholders from the governance process (borne by excluded stakeholders) (Borzaga and Sacchetti, 2015).

For the law:

"Social cooperatives are intended to pursue the general interest of the community to human promotion and social integration of citizens through:

A) the management of social, health and educational services [Type A]

B) carrying out various activities - agricultural, industrial, commercial or services - aimed at providing employment for disadvantaged persons. [Type B]

(Parlamento Italiano, L. 381/1991; Art. 1)¹

¹ translated by the author; specifications in brackets [Type A] [Type B] are added by the author; see Thomas, 2004, for more details on Types A and B).

Together, the differentiation between Type A and Type B introduced by the 1991 law has facilitated the organisation of systemic solutions to welfare problems. Consortia or groups including Type A and Type B cooperatives address a variety of complementary societal goals, from elderly care, to housing, to rehabilitation of psychiatric patients (Type A social cooperatives), as well as work integration in manufacturing, agriculture, and service activities (Type B social cooperatives)

The objective of social cooperatives was to produce welfare services, support employment and, more generally, to produce meritorious goods (Bacchiega and Borzaga, 2001; Weisbrod, 1988). Specialized welfare services and work integration can be considered an example of meritorious goods that can lead to the reduction of social marginalisation. Moreover, because of their “public” aims, social cooperatives have grown to represent specific forms of social enterprise which, in the European tradition places emphasis on social aims, participatory governance, and limited profit distribution (Cf. European Parliament, 2012). Democratic membership embodies the participatory requirement, while commercial goals are instrumental to the pursuit of social aims. This emphasis on participatory governance has deep roots in the country’s cooperative tradition that had already developed in social service provision prior to the law, as well as in other sectors, such as farming, banking, manufacturing, and retailing.

Moreover, the idea of stakeholder participation was supported by the broader framework set by the Civil Code (art. 2540 and 2542), which regulates representation either through the Board of Directors or by the institution of multiple Assemblies for each of the stakeholders.

Does this mean that in practice all stakeholders have equal authority within the governance structure? Not necessarily. It is, in fact, recognised that in Type A co-ops the worker interest tends to be dominant. One interesting question is how a model with a prevalence of worker membership sets out to pursue the interest of users, typically disadvantaged categories of individuals. Social cooperative membership, in fact, has mainly included workers, volunteers and, less

frequently, other non-profit organisations,² whilst users have been scarcely represented, especially in Type A cooperatives. So, differently from ordinary co-ops, Type A, and to some extent Type B, social cooperatives cannot be considered mutual organisations, since their activities are directed towards the benefit of users rather than the co-op's main patron (cf. Cafaggi and Iamiceli, 2009).

Type A cooperative statutes tend to emphasise community welfare objectives to be pursued in partnership with public and private organizations. Stakeholders retain control through the Assembly, have the right to elect directors and, indirectly, the board president.

Having analysed a number of Type A social cooperatives,³ a possible answer to the question of why workers would pursue users' interests is that although, as a norm, beneficiaries are not members, their welfare is nonetheless the *sine qua non* condition for the existence of the cooperative. Because of the social nature and aims of the cooperative project, worker members understand that their authority is legitimised only if it is instrumental to the benefit of vulnerable categories. In other words, there is a "social contract" that ties controlling publics (mostly workers, often paired by volunteers) with non-controlling publics (beneficiaries).⁴

The answer is different for Type B cooperatives. Type B cooperatives focus on work-integration and strive to develop work opportunities at the best possible conditions for all worker members, including users. In Type B cooperatives beneficiaries of work-integration services should preferably be members (albeit not necessarily). In fact, when hired by a Type B cooperative, users can become worker members with the same statutory rights of other ordinary worker members. Where this happens systematically, it represents a way to make users part of the governance structure. Thus, the welfare of ordinary workers is inexorably related to the presence and welfare of workers with difficulties, since

² The Assembly works with the one-head-one vote rule, with the exception of members with the status of legal entities (which can express up to five votes), and financial organisations. For the latter, votes cannot go over one third of those attributed to ordinary members, and nomination rights in the Board of Directors are limited to less than one third (for detailed analysis of the Italian legislation, cf. Cafaggi and Iamiceli, 2009).

³ See Sacchetti and Tortia (2014); Sacchetti (2016) for illustrative cases.

⁴ On social contract, see Brummer, 1991; Donaldson, 1982; Flannigan, 1989; Sacconi, 2013.

these cooperatives find their reason to exist only if they succeed in integrating user-workers (by law with a proportion of 30:70). With this member composition, directors and managers must be clear about their duty, which is simultaneously to maximise the welfare of both type of workers.

In 2006 another piece of legislation instituted the social enterprise model. With the new regulation, the social cooperative form defined in 1991 became just one organisational model among others (including also associations, foundations and other than cooperative businesses). The social enterprise regulation interpreted the participatory governance criterion by requiring openness in the selection of stakeholder members. There are no specific prescriptions on who the members should be, albeit specific attention in the law is dedicated to beneficiaries and workers. In general, it is the social enterprise, through the Assembly, that has the right to identify classes of stakeholders.⁵ The multi-stakeholder social enterprise (MSSE) can include stakeholders as organisational members or as board members. Through these bodies, stakeholders can contribute to strategic decision-making, including what to produce, and how to distribute economic surplus under the limited distribution constraint. As Borzaga and Mittone (1997) notice, this participative form of governance (paired with a social aim and a non-profit distribution constrain) leads to a unique feature, which is that the activities of the organisation have multiple categories of beneficiaries, including members but also non-members.

This principle was already recognised in 1991 and it had been partly implemented. Even before the 2006 law that instituted a “non-discrimination principle” in relation to stakeholder admission practices, in many instances social cooperatives had put in place solutions for the representation of multiple

⁵ Similar requirements were introduced in other countries. However, while Italy introduced a ‘non discrimination principle’ in the selection of members, France has been the only European country where multistakeholding became a specific requirement. The SCIC (Société Coopérative d’Intérêt Collectif) specifies the three types of members that must be represented in the board: workers and beneficiaries, plus a third category to be nominated. In France moreover (unlike Italy where the legislator pursued the idea of independence of SE from the public sector) public administrations can also be members of a social enterprise.

interests and needs in the form of committees representing beneficiaries or their families (Cafaggi and Iamiceli, 2009).

Despite encouraging pluralism, the 2006 legislation activated other business forms only to a limited extent. Today, the majority of Italian social enterprises is still defined by the social cooperation model, to an extent that the two categories nearly overlap. Workers still remain the main stakeholder to be represented in Italian social cooperatives, but their representation is not exclusive. Borzaga et al. (2011) have undertaken some research to map the governance status of these organisations. They evidence that nearly 80 percent of enterprises providing personal, social and work integration services feature some form of multiple stakeholder involvement. Specifically, one out of three social cooperatives (34 percent) are multi-stakeholder, although users are included in the membership in one out of ten social cooperatives. 29 percent are hybrid organisations with multiple membership but with a single stakeholder (workers) represented in the board of directors. 16% percent have a dual stakeholding (including workers and volunteers), whilst the remaining 21 percent are mono-stakeholder (workers) social cooperatives. Borzaga and Depedri (2014) have further noticed that users are members in the majority of Type B social cooperatives (across sectors, e.g. environmental maintenance, manufacturing), whilst Type A cooperatives (typically providing health assistance and educational services) tend not to involve users.

Some research questions

Several questions emerge out of this preliminary discussion that might usefully be the focus of further research:

1. Is single-stakeholder governance more likely in highly commercial sectors where competitive pressures are high and market pricing is important? Is multi-stakeholding more likely when the market pressures are lower and prices are set by negotiation with funding agencies such as local authorities?
2. Is multi-stakeholder governance found in social care because it has these specific characteristics: contracts are long-term, service users find it difficult to

assess the quality of the product, and the product itself is dependent on the relationship between service provider and user?

3. Is it possible to operate a multi-stakeholder governance without bringing more than one stakeholder into ownership? In other words, is ownership less important than we might think?
4. Is it possible in co-operatives that focus mainly on the needs of one owner – producer or consumer – to broaden their governance to include other stakeholders? If so, will this provide a business advantage, or will it lead to a loss of focus and higher governance costs compared to those of competitors?
5. In some countries (England and Wales for instance) the health and social care sectors are becoming increasingly commercial, with new agencies being formed to bid for contracts. Some are multi-stakeholding (mainly workers, service users), some single (usually the workers). In this scenario, which type can we expect to have more success?
6. What are the factors that can lower the internal costs of multi-stakeholding and increase a culture of stakeholder inclusion among directors?
7. Within the multi-stakeholder organisation, what factors contribute to ensure the engagement of stakeholders in collective action?

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